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ISSUE: Capitalization of Cable Television Franchise Costs

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APPROVED:

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STATEMENT OF ISSUE

Whether costs incurred in the acquisition of a cable television (CATV) franchise from a municipality are I.R.C. section 263 capital expenditures or section 162 expenses.

EXAMINATION DIVISION'S POSITION

Costs incurred to acquire a cable television franchise from a municipality are capital expenditures within the meaning of section 263 of the Code.

DISCUSSION

Section 195(a) of the Code provides that no deduction shall be allowed for start-up expenditures unless provided for in Section 195. Section 195(b) provides further that at the election of the taxpayers, start-up expenditures may be treated as deferred expenses and prorated over a period of not less than 60 months. Section 195(c) defines start-up expenditures as amounts paid or incurred in connection with:
(i) investigating the creation or acquisition of an active trade or business, or (ii) creating an active trade or business, or (iii) any activity engaged in for profit and for the production of income before the day on which the trade or business begins, in anticipation of such activity becoming an active trade or business.

The term "start-up expenditures" does not include any amount with respect to which a deduction is allowable under sections 163(a), 164, or 174. The Senate Finance Committee explains "start-up" costs for purposes of Section 195(Senate Finance Committee Report on the Miscellaneous Revenue Act of 1980, P.L. 96-605). "Start-up or preopening expenses are costs which are incurred subsequent to a decision to acquire or establish a particular business and prior to its actual operation. Generally, the term "start-up refers to expenses which would be deductible currently if they were incurred after the commencement of the particular business operation to which they relate". (underscoring added)

Revenue Ruling 86-71,1986-1 C.B. 102 holds that an amount paid for the preparation of an application for a F.C.C. license to operate a radio system is a capital expenditure and not deductible

as an expense under section 212 of the Code. The expenditures in question are not sections 162 or 212 expenses, but costs incurred in obtaining a CATV franchise, which is a separate and distinct asset, with a useful life in excess of one year. Examination identified the following expenditures:

- o Application fees: paid to city
- o Marketing and Development
- o Travel and Entertainment
- o Postage
- o Proposal Printing and Graphics
- o Educational Seminars
- o Slide Shows
- o Brochures and Advertising
- o Engineering Studies
- o Utilities
- o Office Supplies
- o Telephone and Telegraph
- o Salaries and Wages
- o Promotion
- o Insurance
- o Legal and Accounting Fees
- o Miscellaneous

The controversy is the traditional one of when does an item that is normally an expense become a capital expenditure. Section 263 of the code provides that no deduction shall be allowed for a capital expenditure. Section 161 of the Code provides that,in computing taxable income under section 63, there shall be allowed as deductions the items specified in this part, subject to the exceptions provided in part IX (sec. 261 and following, relating to items not deductible). (underscoring added.)

The Supreme Court in Indopco, Inc v Commissioner, No. 90-1278 (February 26, 1992) held that a taxpayer's realization of benefits beyond the year in which the expenditure is incurred is important in determining whether the appropriate tax treatment is immediate deduction or capitalization. In this situation, an asset in fact resulted from the expenditures made. In the previously cited case, the Supreme Court held that expenditures that benefitted the taxpayer beyond the taxable year were capital even if no asset resulted. The Court further pointed out that deductions for expenses under section 162 of the code are exceptions to the norm of capitalization and are allowed only if there is clear provisions for them in the Code and the taxpayer has met the burden of showing a right to the deductions. See Lincoln Savings & Loan Association, 403 U.S. 345, 354 (1971).